

## Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-03  
INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03  
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07  
CEA-01 ABF-01 IO-13 /103 W  
-----067501 100445Z /15/64

R 070911Z APR 78  
FM AMEMBASSY KATHMANDU  
TO SECSTATE WASHDC 1652  
INFO AMEMBASSY NEW DELHI  
AMEMBASSY DACCA  
AMEMBASSY ISLAMABAD

LIMITED OFFICIAL USE SECTION 1 OF 2 KATHMANDU 1790

C O R R E C T E D C O P Y (TEXT GARBLED THROUGHOUT)

E.O. 11652: N/A  
TAGS: ETRD, NP  
SUBJECT: GON INTRODUCES ADDITIONAL CURRENCY/TRADE CONTROL  
MEASURES

REF: KATHMANDU 1505

1. SUMMARY: FOLLOWING ON CURRENCY DEVALUATION/REVALUATION  
(REFTEL) GON MARCH 30 ANNOUNCED SWEEPING CHANGES IN COUNTRY'S  
TRADING SYSTEM. PROVISIONS INCLUDE END OF "BONUS-SYSTEM";  
SECOND, HIGHER EXCHANGE RATE RELATING TO MOST TRADE TRANSACTIONS;  
SEPARATE CATEGORIES OF IMPORT ITEMS WITH DIFFERENT GOVERNING  
CONDITIONS; AND GENERAL LOOSENING OF LICENSING PROCEDURES. OB-  
JECTIVES APPEAR TO BE (A) TO SIMPLIFY AND REMOVE ABUSES IN  
SYSTEM; (B) TO CURTAIL SMUGGLING TO INDIA; AND (YC) HOPEFULLY  
BUILD MORE STABLE FOUNDATION FOR NEPAL'S EXPORT TRADE. FURTHER  
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ADJUSTMENTS APPEAR LIKELY AS EXPERIENCE REVEALS WEAK POINTS IN  
NEW STRUCTURE. IN MEANTIME, GON ALREADY BEING ACCUSED BY  
CRITICS OF SELLING OUT TO INDIA IN RETURN FOR TRADE AND TRANSIT  
TREATIES. WHILE WE BELIEVE GOOD CASE CAN BE MADE FOR DECISIONS  
TAKEN IN TERMS NEPAL'S OWN SELF-INTEREST, SKEPTICS ONLY LIKELY BE  
CONVINCED WHEN AND IF NEW PROCEDURES PROVE THEIR EFFECTIVENESS.  
END SUMMARY.

2. GON MARCH 30 ANNOUNCED MAJOR NEW MEASURES RE CURRENCY EXCHANGE AND IMPORT/EXPORT LICENSING ARRANGEMENTS WHICH INSTITUTE SHARP CHANGE IN COUNTRY'S TRADE SYSTEM. CHANGE AS FOLLOWS: (A) SIXTEEN YEAR OLD "BONUS SYSTEM" ALLOWING IMPORT ENTITLEMENTS ON PERCENTAGE BASIS OF EXPORTS TO THIRD COUNTRIES (I.E. OTHER THAN INDIA) ABOLISHED. (B) DUAL EXCHANGE RATE FOR US DOLLAR TRANSACTIONS HAS BEEN INSTITUTED. RATE FOR NORMAL MARKET TRANSACTIONS (AND SOME TRADE, SEE MORE BELOW) REMAINS AT NRS 12.00 TO ONE DOLLAR (REFTEL), BUT RATE COVERING MOST NON-INDIAN TRADE TRANSACTIONS WILL BE NRS 16.00 TO THE DOLLAR. (IN PRACTICE RASTRA BANK WILL OPERATE OFF SPREAD, OFFERING NRS 15.90 FOR DOLLARS EARNED AND SELLING AT NRS 16.10). (C) POTENTIAL IMPORTS WILL BE DIVIDED INTO FOUR BASIC CATEGORIES: FORBIDDEN ITEMS (E.G. EXPLOSIVES); LUXURY TYPE GOODS WHICH WILL BE SUBJECT TO QUANTITATIVE LIMITATIONS; DEVELOPMENT GOODS; AND ALL OTHER ITEMS. FOR LATTER TWO CATEGORIES IMPORT LICENSES WILL BE FREELY AVAILABLE AND BE ISSUED "AUTOMATICALLY". DISTINCTION BETWEEN THESE TWO CATEGORIES RELATES TO PURCHASE RATE FOR FOREIGN EXCHANGE: FOR DEVELOPMENT GOODS BASIC RATE OF NRS 12.00 WILL APPLY WHILE FOR OTHER ITEMS (AS WELL AS FOR LUXURY IMPORTS) SECOND RATE OF NRS 16.00 WILL BE IMPOSED. (D) EARNINGS FROM INVISABLES (E.G. GURKHA REMITTANCES), CAPITAL TRANSFERS, ROUTISM AND THE LIKE WILL CONTINUE TO BE CONVERTED AT BASIC NRS 12.00 RATE. LIMITED OFFICIAL USE

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(E) RETURNS FROM ALL COMMODITY EXPORTS TO THIRD COUNTRIES WILL BE CONVERTED AT SECOND RATE OF NRS 16.00. AS WITH NON-RESTRICTED IMPORTS, EXPORT LICENSES WILL BE "AUTOMATICALLY" ISSUED. (F) LICENSING REQUIREMENTS LIFTED ALTOGETHER ON SMALL NUMBER OF ITEMS ON BOTH EXPORT AND IMPORT LISTS.

3. BASED ON CONVERSATIONS WITH MINISTER OF FINANCE AND OFFICIALS OF NATIONAL PLANNING COMMISSION AND RASTRA (NATIONAL) BANK OUR BEST READING ON INTENDED OBJECTIVES OF ABOVE CHANGES AS FOLLOWS: (A) END OF BONUS SYSTEM--WHILE BONUS SYSTEM HAD BEEN SUCCESSFUL OVER YEARS IN DIVERSIFYING NEPALESE TRADE TO SOME DEGREE AWAY FROM INDIA, IT WAS BASED, IN EFFECTIVE TERMS ON MULTIPLE EXCHANGE RATES, SOME SHIFTING DAILY. THIS PRODUCED UNCERTAINTY, ENCOURAGED SPECULATION AND CORRUPTION AND TENDED REDUCE INCENTIVES FOR INVESTMENT IN EXPORT TYPE INDUSTRIES WHERE GREATER DEGREE OF CERTAINTY RE FUTURE CONDITIONS REQUIRED. CON OFFICIALS MAKE NO BONES THAT, ADDED TO THESE DOMESTIC CONSIDERATIONS, WAS FACT THAT INDIA OBJECTED TO BONUS SYSTEM AS ENCOURAGING CROSS BORDER SMUGGLING. NO GON OFFICIAL HAS ADMITTED THAT BONUS SYSTEM ABOLISHED IN RESPONSE TO DIRECT GOI INTERVENTIONS, BUT TTHEY HAVE ACKNOWLEDGED THAT ITS DEMISE AND NEW CONTROLS ON LUXURY ITEMS WILL HOPEFULLY COMBINE TO REDUCE SMUGGLING.

(B) DUAL EXCHANGE RATES--GON OFFICIALS ARGUE THAT NEPALESE GOODS STILL CANNOT COMPETE ON OUTSIDE MARKETS AT BASIC RATE, THAT SOME FROM OF SUBSIDY STKLL REQUIRED. HENCE THE PREMIUM RATE. WHILE NEW RATE OFFERS EXPORTER SOMEWHAT LESS THAN HE MIGHT HAVE ACHIEVED UNDER OLD BONUS SYSTEM WHEN HE SOLD HIS IMPORT ENTITLEMENTS, IN MOST CASES IT STILL GIVES REASONABLE PROFIT AND MORE IMPORTANT A GUARANTEED RATE OF RETURN. IN SPECIAL CASES WHERE NEW RATES DO NOT PROVIDE ENOUGH MARGIN (JUTE PRODUCTS CURRENTLY IN THIS CATEGORY) ADDED SUBSIDIES OUTSIDE EXCHANGE SYSTEM WILL HAVE TO BE OFFERED TO EXTENT REQUIRED. THUS MINISTRY OF INDUSTRY AND COMMERCE HAS ANNOUNCED EST WILL PROVIDE EXTRA SUPPORT FOR JUTE DEALERS.

(C) CATEGORIES OF IMPORTS--CONTROL OF LUXURY GOOD IMPORTS WILL BE EXERCISED THROUGH HIGH LEVEL COMMITTEE HEADED BY MINISTER LIMITED OFFICIAL USE

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OF FINANCE. SEVENTEEN CATEGORIES OF GOODS FROM CARS, TO ZIP-

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INR-10 NSAE-00 ICA-11 TRSE-00 XMB-02 OPIC-03  
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07  
CEA-01 ABF-01 IO-13 /103 W  
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R 070911Z APR 78  
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FASTENERS TO TETRACYCLINE HAVE BEEN SO DESIGNATED. SOME GENUINELY DESERVE "LUXURY" LABEL, OTHERS ARE CLEARLY AMONG PRIME ITEMS TRADITIONALLY "DEVIATED" INTO INDIA. IT ANTICIPATED (ALTHOUGH NOT YET SPECIFIED) THAT ALL IMPORTS WILL BE MADE

BY GON'S NATIONAL TRADING CO. WITH LEVELS SET AFTER FURTHER STUDY. AS FOR DISTINCTION BETWEEN "DEVELOPMENT" AND "OTHER" GOODS, INTENT CLEARLY IS TO FAVOR IMPORTS OF FOURTEEN CATEGORIES GIVEN FORMER LABEL. THESE GOODS SHOULD BE CLEARLY CHEAPER THAN UNDER OLD SYSTEM WHILE REAL COST OF FOREIGN EXCHANGE FOR OTHER ITEMS SHOULD CHANGE LITTLE. WHAT WILL BE INTERESTING-- AND WHAT GON OFFICIALS ACKNOWLEDGE MUST BE CAREFULLY WATCHED-- IS EXACTLY WHAT GOODS, AND IN WHAT QUANTITIES, WILL BE BROUGHT IN UNDER THIS ESSENTIALLY FREE IMPORT SYSTEM. WILL INTERNAL NEEDS BE MET? WILL INCENTIVES BE CREATED FOR GREATER SMUGGLING IN CERTAIN KEY GOODS--E.G. TEXTILES WHICH ARE NOT ON CONTROLLED LUXURY LIST, BUT WHICH HAVE BEEN HIGH ON SUSPECTED ILLICIT TRAFFIC LIST? GON OFFICIALS EXPECT IT WILL TAKE SEVERAL MONTHS TO SEE WHAT PATTERN DEVELOPS, AFTER WHICH THEY HINT FURTHER ACTIONS MIGHT BE EXPECTED. (THERE IS ALREADY SPECULATION THAT SOME FORM OF DUTIES MIGHT BE IMPOSED ON LIMITED OFFICIAL USE

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SELECTED THIRD COUNTRY ITEMS).

(D) GENERAL LIBERALIZATION--MOST OF MEASURES IN ONE WAY OR OTHER MAKE EXPORT/IMPORT BUSINESS HERE IN THEORY MUCH SIMPLIER. IT CLEARLY HOPED THIS WILL FACILITATE TRADE IN BOTH DIRECTIONS WITH THIRD COUNTRIES, THUS HELPING FURTHER REDUCE INDIAN DOMINANCE.

4. COMMENT: WHILE ONE OF KEY MOTIVES IN ADOPTING ABOVE MEASURES WAS CLEARLY EFFORT TO REDUCE SMUGGLING TO INDIA, IT IS OUR READING THAT NEW SYSTEM MAKES CONSIDERABLE SENSE FROM STANDPOINT OF NEPAL PUTTING ITS OWN ECONOMIC HOUSE IN ORDER. BONUS SYSTEM DID TEND BREED CORRUPTION UNCERTAINTIES/ FLUCTUATIONS AND TENDED FAVOR QUICK BUCK OPERATOR RATHER THAN LONGER TERM INVESTOR. NEW SYSTEM MAY NOT PROVIDE ALL ANSWERS AND FURTHER REFINEMENTS TO BE EXPECTED, BUT IT DOES APPEAR TO BE REASONABLE APPROACH MUCH IN LINE WITH URGINGS OF IMF OVER PAST FEW YEARS TO SIMPLIFY SYSTEM. UNFORTUNATELY, HOWEVER, NO MATTER HOW SOUND THE DECISIONS, IT ALREADY CLEAR THAT A NUMBER OF NEPALESE ARE VIEWING THESE MEASURES AS PRICE NEPAL PAID FOR TRADE AND TRANSIT AGREEMENT--AND THEY QUICKLY REACHING CONCLUSION THAT NEPAL IS LOSER ON DEAL. BEST ANSWER, OF COURSE, WILL BE IF NEW SYSTEM PROVES ITS EFFECTIVENESS IN MONTHS AHEAD.

5. SUBSEQUENT TO DRAFTING ABOVE EMBOFF HAD OCCASION APRIL 5 TO DISCUSS NEW MEASURES WITH INDIAN EMBASSY ECON COUNSELOR CHANDRAN, WHO TOOK RATHER NEGATIVE VIEW OF SITUATION. CHANDRAN STATED HIS EMBASSY STILL GIVING NEW MEASURES CLOSE STUDY BUT HE WAS CONCERNED IN PARTICULAR ABOUT AUTOMATIC LICENSES FOR TEXTILES (PARA 3(C) ABOVE). HE EXPRESSED GRAVE DOUBT THAT GON WOULD BE ABLE CONTROL THESE IMPORTS AND FELT THAT EVEN SEVERAL MONTHS OF EXPERIMENTATION WOULD BE TOO LONG. TEXTILE IMPORTS INTO NEPAL WOULD SKY ROCKET AND IT WOULD ALL END UP IN INDIA.

HE ALSO MENTIONED PERFUMES AS NOT SUBJECT TO CONTROL AND SAID  
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THERE WERE BOUND TO BE OTHER ITEMS NATURAL FOR SMUGGLING AS  
WELL. CHANDRAN SAID HE FEARED NEW SYSTEM WAS GOING TO CAUSE  
MAJOR PROBLEMS AND MORE CONTROLS WOULD DEFINITELY BE REQUIRED.  
AS FINAL NOTE, HE COMMENTED THAT NEPALESE SMUGGLERS  
WERE HAPPY WITH NEW MEASURES AND, FROM INDIAN PERSPECTIVE, THAT  
MEANT THEY HAD TO BE BAD.  
HECK

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## Message Attributes

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**Draft Date:** 07 apr 1978  
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**Decaption Note:**  
**Disposition Action:** RELEASED  
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**Disposition Case Number:** n/a  
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**TAGS:** ETRD, EFIN, NP  
**To:** STATE  
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